As published in

DairyAdvisor™

Risk Management

The greenback, exports, and dairy

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Exhausted elves are putting the last few presents in Santa's sleigh, which stands fully prepped on its North Pole launching pad. The jolly old guy is counting down to blast off with his super-charged reindeer. There's a little one out front showing off his glowing red nose. You get the picture.

Now, wouldn't it be something if that overloaded sleigh included a gift-wrapped rally addressed to the dairy industry, scheduled to arrive just in time for the eggnog!

But as they so often say in Chicago, "Maybe next year!"

With the light of 2015 fading quickly, let's revisit some of the events and developments that have defined the past 12 months. Then we can peer ahead into the mist of 2016.

This year, dairy prices cratered on an "asteroidal" international scale. The contraction of the Chinese economy, the repeated devaluation of their currency, and their virtual disappearance from the export scene all helped to debilitate our markets. At the same time, the expiration of European Union dairy quotas heated up production, and, combined with the Russian dairy ban, brewed a high output concoction that perpetuates the industry's massive, low-price hangover.

On this side of The Pond, domestic milk production surged as lower grain prices helped margins. Nobody seriously sent or tried to hear a distress signal to cut back on production. Consumer demand levels also impressed the U.S. dairy industry and kept domestic pricing resilient for the better part of the year. Granted, prices have since eroded, except for butter. Yet grain prices have remained subdued as well, which has helped the overall equation.

It’s a testament to our domestic dairy industry, and consumers who are back in love with dairy, how well prices have held their ground. We continue to enjoy what is likely to be one of the most important events in decades – a paradigm shift in the American diet in which consumers no longer perceive natural fat as a villain. Now, if not quite a hero, that tasty dairy fat at least is friendly once again. Many QSR (quick service restaurants) are transitioning to butter across their menus, a trend that will likely accelerate in 2016. Hence, we have back-to-back record pricing years for the “yellow giant” and the likely elevation of butter's downside pricing floor.

Looking ahead, the mist is parting and the view into next year is starting to come into focus. There's a glimmer of hope glistening in the snowy landscape of future prices. In Oceania, droughty El Niño is beginning to have an impact. Production is down on a year-on-year basis and cull rates are increasing, a trend that could gain traction in the months ahead.

However, so far in North America, rainy El Niño drought relief for California remains uncertain. Another year of drought would be like striking a match in the fireworks store. The year-on-year disparity in production between the West and Midwest already is significant; California down 5.5% this year and Wisconsin up 4.5% with South Dakota showing the most gain at +13.3%.

Nonetheless, in Santa's global village today, these factors pale in comparison to the main driver: the strength of the U.S. dollar and the weakness of the export market. During 2016, the long-term trend of the greenback's value is going to ultimately decide the fate of dairy pricing.

Currently, the light ahead glimmers red – and I’m not talking about the nose of the creature attached to Santa’s sled. I’m talking about economic policies and currency devaluations that have made U.S. product uncompetitive in the global space. Hikes in U.S. interest rates are only going to exacerbate the situation in the short term and possibly the long term as well.

But things may not be that rosy on the home front anyway. The U.S. Federal Reserve hiking the interest rate at this juncture is hawkish for two reasons. First, they missed the opportunity to raise interest rates about 9-10 months ago when the economy was in better shape to handle such a hike. Second, they raised in order to be able to cut.

What does that mean? It means the Fed is virtually out of bullets and needs stimulus ammunition to combat future lethargy in the economy. This "gimme ammo" signal likely sends a message of no confidence to the international market. Knock-on effects may lead to a weaker U.S. dollar.

At this time of year, it's good to keep in mind that Santa knows whether you've been naughty or nice. So, be careful what you wish for.

With that, I wish you very happy holidays and a prosperous, dairy-rich New Year!